FINANCING THE SOCIAL SECURITY PROGRAM IN THE SOUTH[1]

CLARENCE HEER

University of North Carolina

The Social Security Act of 1935 represents an attempt on the part of the federal government to furnish protection against certain economic hazards and to finance the costs of such protection in a rational and orderly way. Whether the promotion of social security is a desirable and proper function for the federal government to assume is an issue which may now be regarded as settled. However attached we may be to the ideal of individual self-help, recent events indicate that we are willing in practice to strain every resource of government rather than to allow our fellow citizens to starve.

During the last 5 years, the federal government has spent billions of dollars for the relief of economic distress. Responsibility

[1] The factual data used in the preparation of the present survey were obtained from the following sources:

(1) Estimates by states of population 65 years or over and 16 years or under, Social Security Board, Bureau of Research and Statistics, Division of Public Assistance Statistics, *Estimates of Population and Estimates of Number of Persons Eligible for Public Assistance*, mimeographed memorandum of August 28, 1936.

(2) Number of recipients of specified categories of public assistance, also total and average monthly payments to recipients, by states, Social Security Board, Bureau of Research and Statistics, *Selected Current Statistics*, September, 1937, pp. 35, 36 and 37; also *Social Security Bulletin*, October, 1937, for statistics on South Carolina.

(3) States with approved public assistance plans and methods of financing such plans, Social Security Board, Bureau of Public Assistance, *Characteristics of State Plans for Old Age Assistance, Aid to the Blind and Aid to Dependent Children*, Publication, No.'s 16, 17 and 18, April 1, 1937; supplementary information to August 5, 1937, from unpublished data of Division of Public Assistance Statistics and legislative session laws.

(4) State general fund revenues by types of taxes, Twentieth Century Fund, Inc., *Facing the Tax Problem*, Table K, p. 534.

(5) State and local taxes for elementary and secondary schools and statistics of school enrollment, United States Office of Education, *Biennial Survey of Education, Statistics of State School Systems, 1929–30 and 1933–34*; also preliminary unpublished figures on school income from taxes and appropriations for 1935–36.

for rescuing victims of the depression and other economic maladjustments was not thrust upon the national government by virtue of any theory concerning what our central government should or should not do. The simple fact is that, in an emergency which required that the assets of the entire nation be mobilized in order to keep people alive, the federal government proved to be the only agency capable of performing this task effectively.

There is no assurance that the emergency through which we have just passed will not occur again and that the federal government will not once more be saddled with heavy financial responsibilities. It is no more than prudent, therefore, that the federal government prepare itself *now* to meet the next emergency when it comes, and that it take such steps as are economically feasible to reduce the size of our next relief bill. This is essentially the purpose behind the Social Security Act. It seeks to reduce future expenditures for emergency relief by providing protection now against certain economic hazards which are with us even in normal times. It seeks to distribute the cost of this protection through a system of taxes and contributions calculated to produce a minimum of socially harmful effects.

I

The provisions of the Social Security Act are too well known to require extended comment. They constitute a cooperative federal-state plan for the administration and financing of 5 main types of benefits—unemployment compensation, old-age benefits, old-age assistance, aid to dependent children, and aid to the blind. Under the act, the cost of providing workers with a minimum of protection against the hazards of unemployment is placed on industry through the medium of a national pay-roll tax on all employers of 8 persons or more. The old-age benefit features of the act provide in effect for a national system of compulsory old-age insurance, the cost of which will be divided between insured workers and their employers.

Coverage under the old-age benefit plan does not extend to workers in agriculture, nor to those engaged in domestic service and certain other employments. Moreover, since the benefits payable to an individual will depend upon the amount of his own

contributions, the old-age benefit plan will offer little or no protection to those who are now approaching, or who have already reached, old age. The old-age assistance sections of the Social Security Act have, accordingly, been designed to help the states to give immediate assistance to aged individuals on a basis of need. Initiative in the establishment of old-age assistance plans rests with the states. The federal government, however, undertakes to bear one-half of the cost of all old-age assistance payments made under approved state plans up to a maximum federal contribution of $15 per recipient per month. Funds for the financing of old-age assistance payments are raised through general taxation. The Social Security Act does not specify in what proportions old-age assistance costs shall be divided between the states and their local political sub-divisions. To be approved by the Social Security Board, however, a plan must provide for at least some degree of state financial participation.

Substantially similar to the provisions for old-age assistance are the provisions for aid to dependent children and aid to the blind. The federal government stands prepared to contribute toward the cost of each of these types of benefits, provided the states assume the initiative in setting up state-wide plans which meet the approval of the federal Social Security Board. As regards aid to dependent children, the federal government undertakes to supply a third of all sums expended under an approved state plan up to a maximum federal contribution of $6 per child per month. As regards aid to the blind, it offers to contribute half of all payments made up to a maximum of $15 per month per recipient.

The issues raised by the Social Security Act at the present time do not hinge around the question of whether governmental action to promote social security is or is not desirable. As has already been indicated, that question has been settled. The issues which remain relate to specific provisions of the act and to questions of method and procedure. When the Social Security Act was passed two years ago, we had almost no previous experience with the operation and effects of legislation of this character. Under the circumstances it would be a miracle, indeed, if all of the present provisions of the act should prove in practice to be perfectly adapted to the ends they are designed to serve. Those who are

in sympathy with the major purposes of the Social Security Act will, accordingly, critically observe its workings during these first years of its operation, and they will not hesitate to make constructive suggestions for change whenever experience reveals unanticipated weaknesses in any of its provisions.

It is unnecessary to point out in this connection that no aspects of the social security program will require more careful observation and study than the methods by which various types of benefits are financed and the effects which these methods have on the general public welfare. The benefits provided under the Social Security Act are clearly desirable, but whether these benefits actually produce a net balance of social gain will depend upon the manner in which the funds to pay for them are raised.

II

As economists interested primarily in the problems of the South, we need not for the present concern ourselves with the financing of old-age benefits and unemployment compensation, since both of these types of benefits are in effect supported by national taxes and raise no problems peculiar to the South. As has been previously indicated, however, the Social Security Act contemplates that one-half of the cost of old-age assistance and aid to the blind and two-thirds of the cost of aid to dependent children be supplied by the states or by the states and their local sub-divisions. The states are under no compulsion to set up plans providing for these three categories of assistance. They are free to fix their own scales of benefit payments, and may raise the funds to finance these payments in whatever ways they choose. It is thus apparent that the public assistance provisions of the Social Security Act leave room for wide interstate and inter-regional differences, both as regards the degree of protection afforded by the act and as regards the social effects of the fiscal methods used. This consideration gives point to a survey of the financial aspects of the social security program in the South.

For the purposes of this survey the South has been taken to mean the block of 11 states comprising Virginia, the two Carolinas, Georgia, Florida, Kentucky, Tennessee, Alabama, Mississippi, Louisiana, and Arkansas. Before reviewing the ways in which

these Southern states are financing their share of the public assistance program, it will be profitable to give some attention to certain related matters. First, to what extent have the Southern states cooperated with the federal government by adopting approved plans for each of the three categories of public assistance? Second, how liberally are the Southern states supporting their public assistance plans, as evidenced by the ratio of benefit recipients to the total population of eligible age, and by the average size of the benefits paid per recipient? Finally, what will be the probable total cost of state public assistance plans when these plans reach something like their full stride, a year or two hence?

As regards the first of these questions, the available data would seem to show that the South has been somewhat slower than the rest of the country in adopting approved public assistance plans. Of the 11 Southern states, all but one, Virginia, now have approved plans for old-age assistance. Only 7 Southern states, however, have as yet adopted approved plans for aid to dependent children and for aid to the blind. The 4 states in which the latter types of plans are still lacking are Virginia, Kentucky, Florida and Mississippi. Reduced to percentages, the compliance ratio of the South in respect of old-age assistance is 91 per cent as compared with a ratio of 100 per cent for the remainder of the United States. In respect of aid to dependent children and aid to the blind, the Southern compliance ratios both stand at 64 per cent as compared with ratios of 78 and 81 per cent respectively for the rest of the country.

The best measure of the relative liberality with which public assistance plans are being administered in the South is supplied by current statistics of old-age assistance. This form of relief represents the most costly item in the public assistance program and in most Southern states accounts for more than two-thirds of all payments made. In only 5 of the 10 Southern states having old-age assistance plans have those plans been in operation for as long as a year. Little importance may, therefore, be attached to the present ratio of pension recipients to the total population 65 years of age or over. It is significant, however, that in only one of the 5 Southern states which adopted old-age assistance plans as early as 1936 is the present ratio of pensioners to the population

over 65 years of age below 20 per cent. Louisiana, with a ratio of 26 per cent as of July, 1937, has at present the highest relative number of pensioners. Kentucky comes next with a ratio of 22 per cent.

The ratios just cited should not be taken as indicative of the possible limits to which the relative number of pensioners may ultimately rise. The possibilities in this direction are revealed by the experience of Oklahoma, where 59 per cent of all persons 65 years of age or over are recipients of old-age assistance. Other states which are giving assistance to a relatively large proportion of their aged citizens are Texas, with a ratio of 44 per cent, and Minnesota, with a ratio of 33 per cent. All told, there are 11 states in the country in which the ratio of old-age pensioners to the total population 65 years of age or more is now above 25 per cent.

If all of the 11 states of the South are taken as a unit, it will appear that only 10 per cent of its residents 65 years of age or over are as yet in receipt of old-age assistance. The comparable ratio for the rest of the United States is 20 per cent. The lower Southern ratio is, of course, due to the tardiness with which old-age assistance plans were initiated in the South, and a rapid rise may be expected in the months immediately ahead.

Although there is reason to believe that the relative number of old-age pensioners in the South will soon approach and perhaps exceed the average for the rest of the country, there is little likelihood of a corresponding approach toward parity in the matter of average pensions paid. Average payments per recipient in the South already show signs of becoming stabilized at comparatively low levels. The average old-age assistance benefit paid by Mississippi in July, 1937, amounted to only $4.25 per recipient. In all other states of the South, however, the average was between $9 and $12.50 per recipient, the latter amount being paid by Tennessee.

For the South as a whole, the average old-age benefit payment amounted to $9.50 per recipient as compared with an average of $19.50 per recipient for the remainder of the United States. It may be noted in passing that there is an even greater disparity between the South and the rest of the country as regards aid to

dependent children, the average payment per child in July, 1937, being about $5.40 in the Southern states as compared with an average of $13.50 per child for the remainder of the states.

At present rates of expenditure the total state and local cost of supporting all three types of public assistance in the South is not running much beyond an average of $1,300,000 per state per year. Present rates of expenditure, however, mean very little since most of the state plans are not yet fully under way. It is reasonable to assume that within the next two years about 25 per cent of all persons 65 years of age or over in the South will be on the pension rolls, and that 2 per cent of all Southern children under 16 years of age will be in receipt of dependency aid. If this assumption proves correct, and if all of the Southern states adopt all three types of public assistance plans, the total cost of such plans to the states and localities, on the basis of their present scale of benefit payments will range above $3,750,000 per annum in Georgia and Tennessee; between $3,000,000 and $3,500,000 per annum in North Carolina and Kentucky; between $2,500,000 and $3,000,000 per annum in Virginia, Alabama and Louisiana; and between $1,500,000 and $2,000,000 a year in South Carolina, Florida and Arkansas.

An approximate idea of what these costs will mean may be obtained by relating them to the sums which the various Southern states raised through taxation for the support of their public schools in 1936. If this is done, it will be seen that prospective public assistance costs will amount to 20 per cent of the cost of public schools in Georgia and Tennessee; to about 16 per cent of school costs in Kentucky and Alabama; and will range from 9 to 15 per cent of school costs in all of the remaining Southern states.

III

It is apparent that the social security program imposes a heavy burden on the South, and this fact increases the potential harm which may result from irrational methods of financing it. How is the program being financed? An initial point to consider is the division of costs between the states and their local political subdivisions. The South shows no significant difference in this respect from the remainder of the United States. Five states,

South Carolina, Florida, Kentucky, Mississippi and Arkansas, provide for complete state support of all phases of the security program. In Georgia the counties contribute a fifth of the total state and local share of public assistance costs; in Tennessee the counties contribute a quarter of such costs; while in North Carolina, Alabama, and Louisiana they contribute half of the costs. Since local tax sources are strictly limited, county support means, in the main, support through the general property tax. In Louisiana, however, parish contributions are financed through special taxes on amusements and gasoline; and in Alabama, county contributions are obtained in part through gasoline taxes.

As regards state financing, in three states of the South, all or part of the yields of certain state taxes have been specifically allocated to finance the security program. These earmarked taxes include a chain-store tax and license taxes in Tennessee; taxes on soft drinks, luxuries, and natural gas in Louisiana; and taxes on chewing gum, slot machines, horse racing, and a portion of the sales-tax receipts in Arkansas.

A majority of the states of the South are defraying their share of the costs of the social security program from general fund revenues. The economic and social effects incident to the financing of these costs are, therefore, inseparable from the effects associated with their general schemes of taxation. In marked contrast to the tax system of the federal government, which raises huge sums through progressive income and inheritance taxes, the tax systems of most of our state governments tend to be regressive, being heavily weighted with taxes which enter into the cost of living. This regressive tendency has become more pronounced in recent years as a result of the extreme lengths to which the states have had to go in order to maintain their revenues during the depression.

State income taxes spread rapidly during the depression and are now in effect in 29 states. In very few of these states, however, has the income tax turned out to be an important source of revenue. The outstanding event in the recent annals of state finance has been the discovery of the rich revenue-yielding possibilities of the retail-sales tax. There has also been a decided increase in the use of special-commodity and so-called nuisance taxes, including taxes on liquor, tobacco, soft drinks, theatre admissions and other indulgences of the masses.

Because of the low average level of income in the South, the predominance of agriculture, and the threat of interstate tax competition, the Southern states in particular have not been able to raise much revenue from the so-called ability taxes and have been forced to adjust their tax systems to reach down to the little man. Inheritance and income taxes accounted for only 15 per cent of the combined general fund receipts of the 11 Southern states in 1936. General sales, liquor, and tobacco taxes, on the other hand, accounted for 33 per cent of the total receipts. It is recognized that the general property tax, when used for state purposes, bears with disproportionate severity upon the farmer whose average income is low. Approximately 23 per cent of the general fund revenues of the 11 Southern states was raised through property taxation in 1936.

To the extent that the social security program in the South is being financed through increased taxation, it is evident that a large part of the needed revenue is being raised through taxes which bear regressively on the poor. There is the possibility, of course, that public assistance funds are being obtained, in part at least, at the cost of other governmental services. The fear has been expressed, for instance, that the new fiscal burdens imposed by public assistance plans may operate to retard the restoration of school budgets to their pre-depression levels. In this connection, it is worth noting that the total amount of tax revenue raised for elementary and secondary schools in the 11 Southern states in 1936 was still 8 per cent below the amount raised in 1930, although school enrollment had in the meantime grown by over 5 per cent. It is also worth remembering that the Southern states still stand at the foot of the scale as regards school expenditure per pupil.

IV

There is unfortunately no common denominator of social welfare which will enable us to measure the real gains afforded by the public assistance program in the South against the untoward effects of the present methods of financing it. Who can say, for instance, whether society gains or loses when, in order to give one aged person a pension of $120 per year, it takes $2 apiece from 60 families subsisting on incomes of $400 per year? We can, however, say with certainty that the net gains obtainable from the social

security program in the South would be greatly enhanced, if the program were not so largely financed through taxes which fall on the very poor.

There is little that the Southern states can do by themselves to better this situation. In an age of specialization and large-scale production, wealth and income tend to concentrate in a few limited areas. No predominantly agricultural states have as yet succeeded in raising any significant proportion of their revenues through progressive income and inheritance taxes. The South, it is true, is becoming industrialized, but the very mobility which enables industries to come to the South is a characteristic which invites other areas to lure them away with the bait of low taxation.

If the states can do little to secure a better distribution of the costs of the public assistance program, can anything be done by the federal government? The Supreme Court has in effect declared that the promotion of social security is a matter of national concern. The Social Security Act is a federal measure and federal taxes are being used to finance nearly half of the cost of state public assistance programs.

Under the present provisions of the act, federal grants to the states for public assistance are made on a matching basis. This means that California, which pays an average old-age pension of $31 per month, receives 7 times as much per pensioner from the federal government as does Mississippi, where the low average of $4.25 per month is paid. But California is able to pay a high average pension with relatively slight financial effort because its taxable capacity is high and Mississippi is forced to pay an inadequate pension, which nevertheless involves considerable financial effort, because its taxable capacity is low. The present basis of distributing federal funds for public assistance thus constitutes a reversal of the ability formula.

To carry out the underlying purposes of the Social Security Act, it is clearly necessary that certain minimum standards of public assistance be maintained throughout the United States. Moreover, since the maintenance of these minimum standards is a matter of national concern, they should be financed in such a way as not to impose unequal burdens on different parts of the country. In view of the existing differences of taxable capacity among the

several states, it will obviously be impossible to satisfy these two requirements as long as the present basis of distributing federal public assistance grants is retained.

Under present conditions, nation-wide minimum standards of public assistance involving no interregional inequalities of tax burdens would seem to be attainable only through some application by the federal government of the equalization fund principle, which has long been used in connection with the distribution of state-aid to local schools. Substitution of the equalization fund plan for the present basis of matched grants would not require any increase in the total amount of federal funds to be distributed. It would merely require that the same amount of funds be distributed among the states in a different way.

Practical techniques for measuring the relative taxable capacities of the several states have already been worked out by specialists in public school finance. It ought not to be too difficult to devise indices of the relative cost in each state of supporting a minimum program of public assistance. Federal funds might then be apportioned among the states on the basis of the ratio which the cost of supporting the minimum program in each state bears to that state's taxable capacity. This method of distribution would permit states with relatively large needs for public assistance and relatively small means to support a defensible minimum program without being compelled to skimp on other necessary public services, or to resort to regressive types of taxation.

The states of the South have a special interest in the proposed change in the method of distributing federal funds which has nothing to do with the fact that their taxable capacity is low. The need for protection under the old-age assistance provisions of the Social Security Act will ultimately be narrowed down to workers in agriculture and domestic service, since workers in other employments will, in time, receive protection in their old age through the operation of the contributory old-age benefit plan. Approximately 54 per cent of all workers in gainful occupations in the South are engated in agriculture and domestic service as compared with a ratio of only 26 per cent for the rest of the country. Even after payments under the old-age benefit plan reach a normal level, the requirements for old-age assistance in the South

will consequently continue to be heavy and will in fact be relatively twice as great as in the remainder of the country. Similar considerations apply in the matter of aid to dependent children. The South has a higher proportion of children under 16 years of age than any other section of the United States and this circumstance will correspondingly increase the relative cost of its child-aid programs.

In view of the facts which have just been reviewed, it is perhaps superfluous to observe in conclusion that, if the purposes of the Social Security Act are not to be frustrated, it will be necessary for the federal government to abandon the present matching basis of distributing federal funds in favor of some form of the equalization principle. If this is not done the security program in the South may turn out to be little more than a sham, the financing of which will nevertheless cause considerable harm to this region.